

Alternative Energy Supply for Western Europe

U.S. Objectives:

1. To convey to the West Europeans our view of the potential for timely development of indigenous Western energy resources.
2. To stress the importance we attach to developing these resources so that European markets are not preempted in the 1990's by increased Soviet gas exports.
3. To inform the Europeans that the U.S. intends to do all it can to free up its own energy markets for export on a reliable, competitive basis.

Analysis

Western Europe's energy markets are rapidly changing. The growing perception that oil prices will be stable or even declining has upset a variety of energy and economic calculations. The recession has caused energy demand to weaken in all major sectors.

Demand for natural gas, one of the fastest growing fuels in Europe in the 1970's, has been hit particularly hard. In the 1980's, incremental supplies of natural gas, including gas from the Soviet Union, will be considerably more expensive than in the past. If oil prices are stable, gas demand may continue to be uncertain, making planning very difficult for gas importing countries.

On the supply side, Europe will face the depletion of two medium-sized Norwegian gas fields, and the intention of the Dutch to reduce (if not eliminate) gas export volumes in order to meet longer-term domestic needs. Norway has major undeveloped deposits, but each represents an engineering challenge and costs are likely to be high. However, the Norwegians are already shopping in the U.S. for the most advanced technology and we understand certain companies (e.g. Shell) are confident the technical challenge can be met at reasonable cost.

This uncertain situation holds the risk that the Soviets will seek to preempt the market for the development of indigenous energy resources, again tempting the Europeans with a gas pipeline mega-project. Using much of the same infrastructure as in the first pipeline, a "second-strand" line could be built for 30 percent less in real terms, but still generate attractive equipment and pipe orders for the Europeans. If such a pipeline were built, it would supply up to 40-45% of West European gas consumption by 2000.

State Dept. review completed.

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Norwegian energy officials have informed us that the giant "Troll" gas field in the North Sea will be ready for advance sale to European gas consumers by as early as 1985. Gas from this field could start to flow in the early 1990's, but large volumes would not be available before the middle of the decade. By itself Troll could provide over half the currently expected increment in continental European gas demand in the 1990's (35 of an estimated 60 billion cubic meters per year), equivalent to, or slightly more than, what a Soviet "second-strand" pipeline could deliver.

The competition for Europe's medium-term gas market, therefore, will be between the Soviets and the Norwegians. It is a competition in which the Soviets can be expected to accept low (or negative) real returns in order to obtain hard currency earnings. For their part, the Norwegians plan to sell their gas to either the UK or continental Europe, wherever the highest price can be obtained. Norway will need the gas sales revenues in 1990's, however, and is keenly interested in countering any Soviet proposals.

Ambassador Evan Galbraith, working with Jim Buckley's interagency Alternative Energy Group, has been exploring the commercial aspects of marketing new supplies of Norwegian gas in Europe. Galbraith believes the most workable approach would be for the Netherlands and Norway to reach an understanding on transporting, storing and marketing gas through the year 2000. With such an agreement, the Dutch could increase current gas export commitments, to be phased out later and the gas replenished upon development of the large new Norwegian fields. As a first phase, a pipeline could be built to land gas in Holland from Norway's Sleipner field for distribution through the existing Dutch gas grid. Subsequently, gas from the Troll field could be fed in. However, at least as of now, Norway refuses to commit its gas supplies to a particular market in advance of commercial negotiations.

Domestically, the Buckley group has been looking at ways in which the U.S. might contribute to European energy security. The group has identified several actions the U.S. could take to enhance our credibility as a reliable and long-term energy supplier to Western Europe, and intends to present such a package to the NSC for its endorsement. Most of these actions will require new legislation, however, and there is serious dissent from OMB, CEA, OPD to some of the recommendations. Nevertheless, we can go ahead and inform the Europeans that as a matter of general policy, the U.S. intends to do all it can to free up its own energy markets so as to allow greater exports on a reliable, competitive basis. Particularly significant for the Europeans as they consider the high cost of future natural gas supplies will be a renewed U.S. commitment to action on gas decontrol.